82-2159

No.

IN THE

Supreme Court of the United States

October Term, 1983

In re B.D. INTERNATIONAL DISCOUNT CORP.,

Debtor-Petitioner.

B.D. INTERNATIONAL DISCOUNT CORP.,

Petitioner,

v.

THE CHASE MANHATTAN BANK
(NATIONAL ASSOCIATION),

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether under section 303(h)(1) of the Bankruptcy Code a debtor can be found to be generally not paying its debts as such debts become due where

(a) a creditor with a large claim has presented substantial evidence of its claim, and

(b) the debtor's business had been wound down, and

(c) the debtor has conceded that other unpaid debts existed as of the date the involuntary petition was filed, and

(d) the debtor rested at trial on the involuntary petition without attempting to demonstrate what ground it had for disputing the large claim or that it was paying its other debts?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTE AND RULES

OTHER

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Statement of the Case

The Chase Manhattan Bank (National Association) ("Chase") commenced this Chapter 7 case against B.D. International Discount Corp. in May 1981 by filing an involuntary petition asserting that B.D. International was generally not paying its debts as such debts became due. At the time of the petition, B.D. International was indebted to Chase in the amount of $7,268,746, plus accrued interest, due to certain erroneous credits and failures to debit B.D. International's account. Chase demanded repayment of the debt when it discovered the

errors. Despite B.D. International's acknowledgement of its indebtedness, (7a, 34a-35a)*, the $7.2 million remains unpaid.

B.D. International's Motion to Dismiss

B.D. International moved to dismiss the petition, contending that Chase was not a qualified petitioning creditor and that even if Chase were a qualified creditor, failure to pay a single creditor could not constitute failure generally to pay debts when due, the test which must be met under section 303(h)(1) before an order for relief can be entered in a controverted involuntary bankruptcy case. In the alternative, B.D. International asked the court to abstain from exercising jurisdiction under section 305(a). (52a-54a)

Bankruptcy Judge Burton R. Lifland considered affidavits and held two hearings at which additional evidence was offered. In the course of the hearings, held in July and August, 1981, B.D. International made a number of significant concessions:

(1) that on the date of the petition, B.D. International was no longer in business and that its affairs had been wound down "essentially" since December 1980;

(2) that B.D. International's attorneys held B.D. International's remaining cash assets ($273,628.77) "in escrow";

(3) that a new company known as B.D. Discount of America Corp. ("B.D. America") had been formed, in November 1980;

(4) that Segrex, S.A., a Swiss corporation, was the sole shareholder of B.D. International;

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* Record references are to the appendix annexed to B.D. International's Petition.

(5) that B.D. International received $710,000 in April 1981 (the month prior to the petition) which it immediately had transferred to Segrex as a "loan"; and,

(6) that Willkie, Farr & Gallagher held a claim against B.D. International on the date of the petition, but that the former owner of B.D. International had paid $75,000 in satisfaction of that claim with funds loaned to him by B.D. America *after* the filing of the petition.

The Bankruptcy Court also considered a List of Creditors filed by B.D. International, which showed that it had at least five creditors on the date of the petition, although counsel argued that at least two of the five identified creditors were not owed anything. Finally, the Court considered a Proof of Claim filed by the City of New York which established *prima facie* (*see* Bankruptcy Rule 301(b)) the City's claim in the amount of $43,320 for taxes, some of which had been unpaid since June 1977.

The Bankruptcy Judge denied the motion to dismiss, finding in a written opinion (46a-54a): (1) that B.D. International's liability to Chase, while disputed, was not contingent and that Chase was an eligible petitioning creditor under section 303(b)(1); (2) that on the date of the petition Chase was not the sole creditor and B.D. International had at least ten creditors with aggregate debts due of more than $120,000, exclusive of the Chase debt; (3) that the record revealed "special circumstances," including a "spectre of fraudulent activities," that warranted entry of an order for relief and the appointment of a trustee; and (4) that abstention would not serve the best interests of creditors.

B.D. International's attempt to appeal from Judge Lifland's interlocutory order denying its motion to dismiss (Interim Bankruptcy Rule 8004) was rejected, but in the course of that appeal the District Court reminded

the Bankruptcy Judge that "it should be doing something to permit himself . . . to know that there is at least a substantial basis for the debt . . . even if it is not a definitive determination that the debt is owing." (7a)

The Trial

Trial on the petition, without a jury, went forward on October 16 and 19, 1981. Chase's evidence consisted of the testimony of a Chase vice president and an attorney for B.D. International and B.D. America; certain books and records, including a December 31, 1980 financial statement, produced by B.D. International; internal memoranda prepared by Chase officials; and various affidavits and transcripts relating to the motion to dismiss.

At the conclusion of Chase's direct case, B.D. International again moved to dismiss, arguing that findings made in the course of prior proceedings in the case should be disregarded. The Court rejected counsel's contention, explaining:

> THE COURT: I made certain determinations, and that's part of the law of the case.
>
> * * *
>
> THE COURT: Mr. Schwartz, I rendered a decision in this case predicated upon certain findings. Having concluded those findings and taken judicial notice of the status of the document [sic] and testimony that's come before me and admissions with respect to an indebtedness due to at least one creditor and statements in open court that there were other creditors of this debtor, I think that is part of the record.

The Court then ruled that Chase had established a *prima facie* case and reserved decision on the motion to dismiss. B.D. International was directed to proceed with its case on the following Monday.

When trial resumed B.D. International rested without calling any witnesses or offering any other evidence.

The Bankruptcy Court's Decision

In a scholarly opinion, the Bankruptcy Court concluded that B.D. International was generally not paying its debts as such debts came due and issued the order for relief. (45a) The Court found:

> B.D. International did not offer a scintilla of substantive proof to rebut the Chase claim, rather it attempted to subvert Chase's presentation with attacks pitched to the niceties of pleadings and proof. Chase clearly established a 'substantial basis' for its claim and as such, it will be included in the calculation of 'generally not paying such debtor's debts as such debts become due'. (36a)

With respect to the ultimate finding as to whether B.D. International was paying its debts as such debts became due, the Bankruptcy Court held:

> The nature of a debtor's conduct of his financial affairs has been viewed as a factor in the generally not paying debts determination. Winding up a business and conducting financial affairs in a manner inconsistent with one operating in good faith and in the regular course of business is conduct that may form the foundation for the entry of an order for relief. *Reed, supra* at 760. While this factor *alone* might be insufficient, given the totality of the record before the Court — the enormity of the past due debt(s), the duration of non-payment, the reduction of some assets into an escrow and concomitant nonoperating status, and the 'special circumstances' brought earlier to the Court's attention — ample support is found for the entry of an order for relief. (41a)

Appeal to the District Court

B.D. International appealed from the entry of an order for relief and the District Court (Edelstein, J.) affirmed in all respects. In particular, Judge Edelstein held (a) that the Bankruptcy Court correctly found under section 303(h)(1) that B.D. International was generally not paying its debts as such debts became due; (b) that competent evidence supported this determination; and (c) that the Bankruptcy Court's findings of fact and conclusions of law were not clearly erroneous. (20a)

Appeal to the Circuit Court

A panel of the Second Circuit Court of Appeals (Judges Friendly, Newman and, by designation, District Court Judge Wyzanski) unanimously affirmed the decision of the District Court, deciding "both phases of this case upon the particular facts here presented." (13a) It found that on any reasonable interpretation of section 303(h)(1), the "peculiar circumstances" warranted the finding that B.D. International was generally not paying its debts as such debts became due. (11a-12a) It further concluded that the court below properly included Chase's $7.2 million claim in the section 303(h)(1) calculation because B.D. International failed to demonstrate "what ground it had for disputing Chase's claim." (12a)

B.D. International's petition for rehearing *en banc* was denied. (1a)

B.D. International's Petition

Although not explicitly made reasons for granting the petition, B.D. International's Statement of the Case would suggest that the Bankruptcy Court made significant errors as to trial procedure and admission of evidence leading to a "miscarriage of justice." (Petition at 12, 17)

We note first that counsel had more than adequate notice that the Bankruptcy Judge would rely on rulings

made in the course of prior proceedings. The Court of Appeals saw no reason why the evidence taken at the dismissal hearing could not be considered at trial. (18a, n.7) *See also In re Gervich*, 570 F.2d 247, 253 (8th Cir. 1978); *In re Colorado Corp.*, 531 F.2d 463, 467 (10th Cir. 1976). Thus B.D. International's argument (Petition at 10) that the *only* evidence introduced at trial involved Chase's $7.2 million claim is groundless. Second, B.D. International takes as a given that the courts below improperly relied on evidence obtained through settlement discussions. But at the time of negotiation B.D. International did not dispute Chase's claim and was only attempting to get more time in which to pay. There was no error in this regard, as the Court of Appeals held. (17a, n. 5) *See also* J. Weinstein & M. Berger, 2 *Weinstein's Evidence* ¶ 408 [01] at 408-10 (1981). Finally, B.D. International argues that it was placed in a "Catch 22" (Petition at 11) with respect to offering evidence as to the merits of its alleged defenses to the "disputed" claim. However, counsel was precluded from demonstrating that its dispute of Chase's claim was *bona fide* only on cross examination during Chase's direct case. When afforded the opportunity to meet Chase's *prima facie* case, B.D. International rested without calling any witnesses or introducing any documentary evidence.

Reasons for Denying the Petition

I

THE DECISION BELOW IS NOT IN CONFLICT WITH THE DECISIONS OF ANY OTHER CIRCUIT COURT

B.D. International would fabricate a conflict where none exists, alleging that the Seventh and Second Circuits disagree as to the application of section 303(h)(1). (Petition at 10-11) To support this argument, B.D. International juxtaposes language from *In re Covey*, 650 F.2d 877 (7th Cir. 1981), with language from the Second

Circuit's opinion in this case. The juxtaposition is misleading.

In *Covey*, the Seventh Circuit did hold "that the resolution of the merits of the disputed claim should be deferred until after the § 303(h) trial . . . ." (Petition at 10) Contrary to B.D. International's implicit assertion, however, the Second Circuit did not hold that the merits of disputed claims should be resolved during the section 303(h)(1) trial or that section 303(h)(1) "required B.D. International 'to demonstrate to the bankruptcy court what ground it had for disputing Chase's claim.' " (Petition at 11) B.D. International was not required to disprove Chase's claim; the excerpted phrase is part of a sentence in which the Second Circuit simply observed that "after having been afforded the opportunity, B.D. [International] failed to demonstrate . . . what ground it had for disputing Chase's claim." (12a) As Judge Friendly found (11a):

> We do not think this is the case in which we should attempt to lay down a definitive rule. Here, the bankruptcy judge was justified in finding that B.D.I. was generally not paying its debts as they became due on any reasonable interpretation of that language. It was not paying Chase; it was not paying Citibank; it had not paid Willkie Farr; it had not paid the City of New York for several years. . . . B.D.I. conceded the indebtedness to Willkie Farr, and the City's proof of claim was sufficient in the absence of any contention that the amount was not owed. Under the peculiar circumstances of this case, this evidence seems sufficient to meet the test of generality. (footnotes omitted)

Although the Second Circuit questioned the "elaborate gloss" that the Seventh Circuit added to the statutory language (Petition at 11), the Court took pains to point out that it "prefer[red] to see some more cases before we decide whether to accept *Covey* . . . as the law of

this Circuit, although our decision here is consistent with it." (13a)

II

THIS CASE PRESENTS NO IMPORTANT QUESTIONS OF LAW THAT SHOULD BE SETTLED BY THIS COURT

B.D. International evidently claims that the Second Circuit wrongly interpreted section 303(h)(1) because it decided that a single creditor whose claim is disputed can force a debtor involuntarily into bankruptcy. (Petition at 13) In fact, the Second Circuit based its decision entirely on the "particular facts here presented," explicitly refusing to lay down a general rule by which to interpret the statutory language. (13a) Judge Friendly's concluding sentence is dispositive on this point:

> It suffices to decide this case that the bankruptcy judge was warranted in finding that B.D.I. was failing to pay not merely Chase but all other creditors and thus was generally not paying its debts as they became due, and that Chase was not disqualified as a petitioning creditor under § 303(b) or as the holder of debt that was not being paid by B.D.I. by virtue of a purported dispute which B.D.I. did not sufficiently support. (14a)

CONCLUSION

This Court should not grant B.D. International's Petition because this case presents neither an issue as to which the circuits are split nor an important question of Federal law. As the Court of Appeals found, the peculiar facts of this case would require affirmance on any reasonable interpretation of the statute.

Dated: New York, New York
July 29, 1983

Respectfully submitted,

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